

D.P.U. 94-23

Investigation by the Department of Public Utilities on its own motion into the regulatory treatment of electric company costs incurred in order to comply with the sulfur dioxide provisions in Title IV of the Clean Air Act Amendments of 1990.

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## I. INTRODUCTION

The Department's purpose in initiating this investigation was to gather comments pertaining to the regulatory treatment of costs related to compliance with the SO<sub>2</sub> provisions of Title IV of the Clean Air Act Amendments of 1990 ("CAAA") in order to provide guidance to (1) establish the specific ratemaking treatment of emission allowance costs and revenues, and (2) ensure that Department policies provide electric companies the proper incentive to select least-cost compliance options that may involve the creation or purchase of emission allowances. D.P.U. 94-23, Notice of Inquiry, ("NOI") at 2. The Department sought comments from parties on three general issues. The Department requested (1) clear explanations of the viability and relative cost-effectiveness of the various options available for electric company compliance with the provisions of Title IV; (2) comments on the possible effects that existing Department ratemaking policies would have on electric company Title IV compliance decisions; and (3) specific recommendations on the appropriate ratemaking treatment of Title IV compliance expenditures and revenues. Id. at 3.

The Department issued its NOI in this case on January 25, 1994, with a list of twelve questions for electric companies focusing broadly and specifically on plans and costs related to compliance with Title IV of the CAAA. Written comments were filed on February 25, 1994, followed by reply comments on March 7, 1994. A public hearing was held on these matters on March 14, 1994. Commenters included state agencies, utilities, independent power producers, environmental groups, industrial concerns, and other interested parties. The written and oral comments reflected considerable thought on the complex set of issues related to compliance with

Title IV of the CAAA. The Department's deliberations have been enhanced by the comments offered by all who made such efforts.

The Department has carefully reviewed and considered all comments received in the course of this proceeding. The Department has also considered its findings in two important Orders that have been issued since the NOI, and that have a direct bearing on electric company compliance with Title IV of the CAAA: Incentive Regulation, D.P.U. 94-158 (1995); and Electric Industry Restructuring, D.P.U. 95-30 (1995). In Section II below, the Department sets forth its findings in this docket in consideration of the comments received, and consistent with its findings in Incentive Regulation and Electric Industry Restructuring.

## II. ANALYSIS AND FINDINGS

In Clean Air Act Amendments of 1990, D.P.U. 93-112-A at 17 (1994), the Department addressed the regulatory review of electric companies' CAAA compliance activities. In particular, the Department found that, in order for a company to collect compliance expenditures where total CAAA compliance expenditures were expected to be below \$250 per kilowatt ("kW"), those expenditures should first be reviewed in a company's rate case to ensure that the compliance activities were least-cost. Furthermore, the Department found that, if CAAA compliance expenditures at a company's generating unit are expected to exceed \$250/kW, thus meeting the definition in 220 C.M.R. § 9.01(3) of major investment, the company shall submit a filing seeking preapproval of that investment. Id. at 16. Finally, the Department established that, to facilitate Department review in future integrated resource management ("IRM")<sup>1</sup> and rate case proceedings,

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<sup>1</sup> On June 1, 1995, the Department replaced the IRM regulations, 220 C.M.R. §§ 10.00 et seq., with a revised set of integrated resource planning regulations. See Integrated

companies should file CAAA compliance information and a demonstration that compliance expenditures are made pursuant to a least-cost plan. Id. at 17-18. In that Order, the Department also found that the existence of a market mechanism for compliance with Title IV of the CAAA raised questions concerning the appropriate ratemaking treatment of compliance costs which could not be addressed within the context of D.P.U. 93-112-A.

A principal issue in this docket has been whether incentives exist or should be developed to ensure that electric companies participate actively in the allowance market in order to achieve least-cost compliance with Title IV provisions. In Incentive Regulation, the Department strongly encouraged all companies within its jurisdiction to devise and propose broad-based incentive ratemaking mechanisms consistent with a specific set of guidelines described in that Order. D.P.U. 94-158, at 65. Although the Department allowed companies to formulate the details of their respective incentive ratemaking mechanisms, it set out specific filing requirements for targeted incentives in certain areas of utility operations that a company concludes cannot be addressed by broad-based mechanisms. Demand-side management and environmental compliance are provided as examples of such areas of utility operation. Id. at 62-63.

In Electric Industry Restructuring, the Department built on the performance-based ratemaking standard established in Incentive Ratemaking. In particular, the Department specifically required that, beginning in February 1996, electric companies file industry restructuring plans with the Department that will start the transition to incentive regulation of transmission, distribution, and (as long as a fully competitive market does not yet exist) generation. D.P.U. 95-30, at 47-48.

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Resource Planning, D.P.U. 94-162 (1995).

Viewed broadly, the Department's Order in D.P.U. 95-30 represents the beginning of the process by which the generation portion of the electric utility industry in Massachusetts provides for customer choice. Among other things, the Order calls for an expeditious transition to a restructured industry that is based on full and fair competition in generation markets and on the functional separation of generation, transmission, and distribution services. Id. at 16, 45. Finally, Electric Industry Restructuring specifically anticipates that the forthcoming changes in the industry will provide incentives for electric company compliance with environmental requirements such as Title IV of the CAAA:

the Department believes that increased competition in the electric industry offers a new opportunity for harnessing market forces in the pursuit of environmental improvement. Increased competition should create greater incentives than currently exist for suppliers to anticipate and minimize the costs of complying with current and future environmental regulations at both existing and new plants.

Id. at 26-27.

As noted in Incentive Ratemaking, the Department is interested in incentive ratemaking mechanisms that provide for a more efficient regulatory approach and that give due consideration to the need for administrative simplicity. D.P.U. 94-158, at 64. In the instant Order, the Department does not identify a particular ratemaking mechanism for the treatment of costs to comply with Title IV of the CAAA. However, consistent with its determinations in Incentive Ratemaking, the Department strongly encourages each company to devise and submit incentive ratemaking proposals that will encourage the creation and trading of SO<sub>2</sub> emission allowances in a manner that is economically efficient and that will benefit ratepayers. The Department expects that such proposals will be consistent with, and addressed in, each company's industry restructuring plan submitted pursuant to the schedule set forth in Electric Industry Restructuring. Plans for incentive

ratemaking treatment of compliance with Title IV of the CAAA will be reviewed on a case-by-case basis at the time such plans are presented.

III. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That future proposals for the ratemaking treatment of costs to comply with Title IV of the CAAA shall be reviewed in a manner consistent with this Order; and it is

FURTHER ORDERED: That the instant proceeding is hereby dismissed.

By Order of the Department,

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Mary Clark Webster, Commissioner

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Janet Gail Besser, Commissioner